Investment Strategy Update

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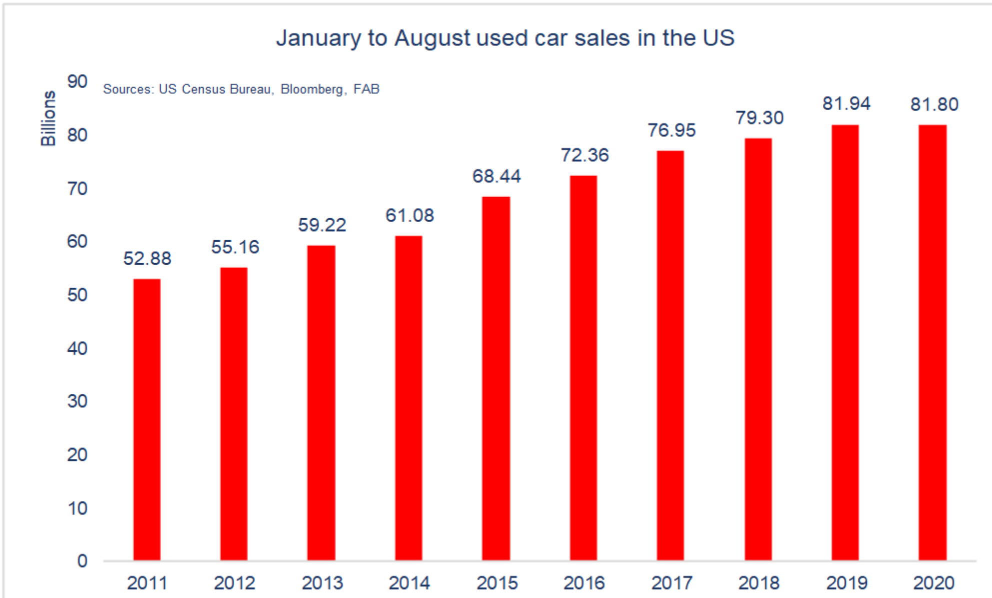
There could be some good news for oil after the pandemic



- **Used car sales in the US are on track for a record year despite a steep drop in sales in April.**
- **Car sales in China were also up year-on-year by 8.2% in September.**
- **Meanwhile, public transport data in China suggests people are trying to avoid buses and trains.**
- **Low oil prices are also making it more affordable to drive and to own larger cars.**
- **These elements together could actually boost oil demand next year.**
- **The FAB AAC remains slightly underweight in equities, and overweight in IG bonds and gold**

It is commonplace to say that the pandemic is changing everything, but one area seems to be benefiting from it, but going unnoticed. Car sales are up in most countries as people try to avoid the crowds inherent in taking public transportation.

This is bad news for the environment, which had gotten a reprieve from people working from home and avoiding movement in the beginning of the pandemic. It is, however, good news for oil prices, as more cars being sold eventually translates into more demand for gasoline.

The kind of cars people are buying also suggests gasoline demand could rise. In its second quarter earnings call, Ford said that pick-ups now made up a bigger part of their sales, while GM said, at the time, that their full-size sport-utility vehicle plant had to operate on three shifts in July to meet pent-up demand.

Other automakers said similar things in their results announcements. That is consistent with history, which shows that muscle cars and pick-up trucks, which consume more fuel, become bestsellers when oil prices are low.

History has another lesson about that sort of dynamic, too. This sort of increase in demand tends to happen just when exploration companies are reducing their capital expenditures because it is less profitable to extract oil in certain locations.

In the past, the two things combined have translated into higher oil prices. For instance, in July 2005, amid low rates and low oil prices, car sales in the US were the second highest in history. Then, a barrel of Brent was selling for about US$50. Within the next three years, Brent crude prices rose to US$139, as supply reduction combined with steady demand growth pushed prices higher. The opposite happened after 2014, as car sales fell and supply investment skyrocketed.

US used car sales are on track for a record year despite a historic plunge in April

Things are not exactly the same now. In the early 2000s, the shale oil industry was marginal. Now, even though the Covid crisis has removed about 2 million barrels of US shale oil from the market, as several smaller companies went bankrupt, that supply can come back pretty quickly, given the advance in exploration technology for so-called tight oil. Hence, there is a cap on how much higher oil prices can go.

Still, for all the doom forecasts being made for oil, there is a chance that the pandemic has just tilted the balance in favour of higher oil prices in the future. At this price level, there will be little new investment in exploration. Yet, more people across the world are driving ever bigger cars. It is probably just a matter of time before these two things push energy prices up.

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